

COMMONWEALTH OF VIRGINIA

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VIRGINIA HOUSING COMMISSION

Mortgages-6/23/08

Members Present:

Delegate Daniel W. Marshall, III- Chair

Delegate Terrie L. Suit

Gary Garczynski

Ted McCormack

Chip Dicks

Dana Fenton

Connie Chamberlin

J.G. Carter

Michele Watson

Susan Hancock

Joe Face

Robert Bradshaw

Travis Hill

Marc Cheatham

J.G. Kemper

Judson McKellar, Jr.

Jay Spruill

Shea Hollifield

Steve Baugher

Alexander Macauley

Jim Naggles

Invited guests:

Steve Sanderford, Federal Reserve Bank of Richmond

Barrett Hardiman, Home Builders Association

Delegate Daniel Marshall called the meeting to order at 9:00 A.M.

The first speaker was **Susan Hancock**, Deputy Commissioner of Consumer Finance, of the State Corporation Commission (SCC).

- The first topic of discussion was HB 1487, which becomes effective July 1, 2008.
 - The bill includes several key changes:

DELEGATE JOHN A. COSGROVE
DELEGATE ROBERT D. HULL
DELEGATE DANIEL W. MARSHALL, III
DELEGATE ROSALYN R. DANCE
DELEGATE TERRIE L. SUIT

SENATOR MAMIE E. LOCKE
SENATOR JOHN C. WATKINS
SENATOR MARY MARGARET WHIPPLE

F. GARY GARCZYNSKI
F. ANDREW HEATWOLE
T. K. SOMANATH

- There is a change the definition of mortgage loan- “owner occupied” stricken
 - The scope is expanded to include more types of loans and lenders.
 - A criminal background checks required for members, senior officers, directors, and principals of an applicant of mortgage license
 - Background checks are also required for new employees of a mortgage licensee
 - The new legislation also requires that licensee trains their staff.
 - Failure to pay appraisal fees will result in revocation of a license.
 - Licensees can be fined for any violation of law and regulation applicable to the business- RESPA, TILA(Truth in Lending Act), ECOA(Equal Credit Opportunity Act), etc. This is to address issues of loan steering.
 - The bill also requires VHC to review new federal legislation to see if changes need to be made at the state level.
- The second topic of discussion was the proposed regulations relating to Mortgage Lenders and Brokers (10VAC5-160)
 - The SCC amended regulations pertaining to mortgage lenders and brokers to address certain provisions of the new legislation.
 - The comment period for the regulations ended today, June 23, 2008.
 - The new regulations were mailed out to mortgage licensees and other interested parties, so that they could review and make comments.
 - A hearing will be held on July 1, 2008 for oral comments.
 - Many definitions have been changed or added (SCC handout for a complete list).
 - The new regulations include criminal records checks for employees, including which employees require a criminal background check.
 - If the licensee wants to hire someone who has a criminal record, it must petition the SCC and state specific reasons, i.e. criteria for exemptions.
 - Training is required for “covered employee” as defined in the regulations.
 - Initial training programs are required, as well as continuing education.
 - The regulations define the scope of education required, including the number of hours required for employees and what types of courses, such as Truth In Lending. Employees must be trained with regard to certain laws and regulations.
 - Twenty-two training hours are required, broken down between federal and state regulations, and hours for mortgage fraud prevention.
 - Eleven hours of continuing education are required, broken down between federal and state regulations, and hours for mortgage fraud prevention
 - Training manuals required to be kept and provided to the SCC, as evidence that each employee completed the required training.
 - A reciprocity clause in the regulations allows the SCC to accept other state requirements in Virginia, for training related to federal laws, but the employee will still need to be complete required training for Virginia laws and regulations.
 - More information is available on the website, www.scc.virgini.gov/bfi

- **Bob Bradshaw** asked a question concerning fines for violations, do these apply to state licensees or are they expanded to federal licensees?
 - Ms. Hancock replied that the regulations only cover state licensees and there are a number of exemptions, such as credit unions, insurance companies, etc. Fines are imposed on those required to be licensed under the MLBA.
- **Delegate Terrie Suit** inquired if the regulations broadly interpret who is required to have the background check: will they apply only to those people who have access to Social Security numbers and other sensitive material, or will they be required for all employees, including those who do ministerial work?
 - Ms. Hancock replied that the background checks would be required for those employees who have access to sensitive data.

The second speaker was **Steve Sanderford**, Federal Reserve Bank of Richmond.

- Mr. Sanderford spoke on the state and national industry trends, giving statistics at both levels.
- In Virginia:
 - Virginia's foreclosure national ranking has jumped significantly, moving up to 12th place.
 - By the end of 2007, 35% of subprime mortgages had interest rates resets.
 - By the end of 2008, 62% of subprime mortgages were cash out refinances
 - The Federal Reserve conducts research, in order to provide detailed analyses to help troubled borrowers in communities
- National picture, how did we get here?
 - Nevada, California, Florida, Arizona, Colorado, Illinois, Michigan, and Georgia hardest hit by foreclosures.
 - Virginia has a moderate foreclosure rate compared to these states
 - National delinquency rates are the worst in subprime ARMs and subprime FRMs
 - Subprime are the poor performers, 13% of mortgages providing 50% of foreclosures.
 - In 2004, there was a major industry switch from FRMs to ARMs, creating higher volumes of lower-priced loans. From 2004 to 2007, there are clear shifts in default rates.
 - Rate resets are not drivers of foreclosures, there other factors:
 - Underwriters
 - clear shift in documentation standards
 - Loan-to-value (LTV) climbing
 - Housing prices
 - Across the nation, 10 years of house price increases with declines in recent periods.
- The Federal Reserve's fifth district, and particularly Virginia, is doing better than the national picture.

- Looking into the Virginia zip codes, the problems are clearly in pockets of metropolitan areas across the state.
- The Virginia picture is similar to the national picture; subprime ARMs show the poorest performance, subprime FRMs are also performing worse than the national average.
- The inventory of mortgages in foreclosure is increasing. In Prince William County, 62% of properties for sale are bankrupt. The volume of houses for sale related to foreclosures is increasing across the state.
- Statistically in Virginia:
 - Most subprime loans in foreclosure are in the Arlington and Alexandria areas.
 - Most of the owner-occupied homes with subprime mortgages are in Virginia Beach and the Northern Virginia regions.
 - Most owner-occupied homes with subprime mortgages, that are 90 days passed due, are concentrated around the metropolitan areas of Virginia.
 - **Delegate Marshall** inquired about the date these statistics were created and when the data was compiled?
 - **Mr. Sanderford** responded that the material is current as of February, 2008. He said if the material went back to 2007, we would see rising statistics for past-dues mortgages.
 - **Delegate Marshall** then asked how often the statistics are updated and if the VHC could receive this information as it is updated.
 - **Mr. Sanderford** responded that it is updated quarterly and that the VHC can receive it through an information request form, which he would leave with **Elizabeth Palen**, Director of VHC.
 - Most ALT- A loans, which have reduced documentation requirements, are in Northern Virginia and Virginia Beach. However, this is a new phenomenon, and there is not a lot of data related to these loans.
- Virginia House Prices:
 - Virginia is above the national average in house price growth, with statistics based on rapid price increases and subsequent price decreases. The Northern Virginia region shows the most growth and then the greatest decline.
- There is ongoing work and questions:
 - What will happen with home prices and sales?
 - Are Alt-A loans the next wave?
 - Will small investors come back into the market?
 - How do we deal with fraud—it is hard to get data in this area.
 - Servicing issues- servicers drive all collections of business.
 - What are the broker/lender impacts? The brokers from two years ago are gone, who fills this void?
 - What are the spillover effects- mixed retail projects, commercial real estate lending.
 - Will there be increasing HELOC delinquencies?
- **Delegate Marshall** asked if there were any questions for **Mr. Sanderford**.

- **Gary Garcynzki** asked if the Federal Reserve was keeping track of inability to pay versus walkaway because of upside down purchases?
 - **Mr. Sanderford** replied that this is hard data to get, like fraud, but in talking with borrowers and realtors, it seems clear that dollar increases are not the main driver.
- **Delegate Terrie Suit** noted that the index used for resets has declined significantly, and asked whether resets are really going up or are the rates staying flat?
 - **Mr. Sanderford** replied that the differences in mortgages are significant, and there were some initial rates (teaser rates) where there were significant resets. There are also option ARMs and negative amortizing loans. However, usually a life event occurs, etc.
- **Connie Chamberlin** asked about underwriting practices.
 - **Mr. Sanderford** replied that documentation standards and LTV were a driving factor for loan defaults and that most banks do not hold mortgages anymore. Rather, mortgage originators who are not traditional bankers hold mortgages and are producing products in a different business. There are poor underwriting practices, but no pure hard statistics exist, other than increasing LTV's, and documentation standards that clearly declining.
- **Delegate Terrie Suit** asked if the market would supply corrections or if policy changes need to be made on federal and state level to correct the problems.
 - **Mr. Sanderford** responded that significant changes were made with regard to HOEPA, which will be effective in July. The mortgage market is clearly self-policed at this point, but going forward, this may change, starting with the Federal changes to HOEPA.
- **John-Garret Kemper** asked whether credit tightening a market cure to the main drivers mentioned (underwriting and home prices).
 - **Mr. Sanderford** responded that tightened standards are emerging.

The third speaker was **Michele Watson, VHDA**, who gave a quick update on the challenges faced at the VHDA.

- The role of housing finance agency is two-fold:
 - To create affordable housing for first-time homebuyers in partnership with private sector.
 - To service loans and use loss-mitigation tools that the private sector cannot because of high volumes.
- There are two challenges that are present:
 - An impact on loan programs- There are many loan requests, and no financial resources to support demands.
 - A threat to VHDA loans- When there are too many foreclosures in a neighborhood it makes it hard for people to sell their property.
- The demand for VHDA funds is 50% to 100% higher than VHDA is able to service.
 - Retrenchment- creates a pressure on housing finance agencies as a source of credit for first-time homebuyers.
 - The entire mortgage product has shifted to restrict first-time home buyers.

- It is difficult to sell tax exempt bonds in the market place, investors are risk-adverse, the rates used to be below market, now they are equal to market or only 15 basis points below market rate.
- VHDA has had to curtail several lending programs-
 - Had to restrict number of mortgage lenders.
 - Had to tighten up loan program guidelines, and to suspend certain loan programs in order to balance supply with demand.
 - Had to remove the stand-alone taxable bond program.
 - **Delegate Marshall** asked a question relating to the bond market.
 - **Judson McClellor** of VHDA said he has never seen this effect on the bond market before, and with the interest rates going up, it is a very unique situation one he has not seen in his 30 years of tenure with VHDA.
- VHDA expects to use \$850 million in bond funds to make loans to first-time homebuyers, but this is a significant reduction from 2007.
- Rising foreclosures are a result of unrestricted use of credit. Borrowers purchased homes that they cannot afford, they did not understand the loan products, and now they owe more on their property than it is actually worth. They are walking away from property because they do not want to pay on it.
- **Delegate Suit** asked whether there is a cultural mentality shift--because of the media about foreclosures, has it become okay to let your house go into foreclosure?
 - **Ms. Watson** replied yes, numbers of people are coming to clinics, many were not in trouble with their loans, they just wanted to walk away. Because there are so many people in default, there is no longer the stigma of foreclosure.
- Concerning foreclosures, 58% of mortgages are subprime, 27% are ARM.
- Forty-seven percent of African Americans and 38% of Hispanics have subprime loans, these households are impacted greatest. VHDA does not have the resources necessary to deal with these issues.
- VHDA is a co-leader on Governor Kaine's Foreclosure Task Force and has trained VHDA members as staff for the Neighborworks program.
- A network of non-profits exists to assist, but most don't know about loss-mitigation in foreclosure.
- VHDA has conducted five foreclosure prevention clinics that close to 700 people attended. There is a public outreach plan and website to help people avoid foreclosure.
- Federal legislation will increase the bond cap that is shared in Virginia, but this is a temporary solution, because the bond cap has short time line for effectiveness.

The final speaker was **Barrett Hardiman**, Vice President of HBAV

- The market looks bleak for the residential construction industry.
- According to the National Association of Home Builders, statewide home production will fall from a record high in 2005, to a reduction of almost 60% in 2008.
- There has been a reduction in construction of new single family homes each year since 2005.
- The metro areas have experienced the largest drops in new construction.

- Lower home production is a major contributor to reduction in sales tax revenue collection by the state.
 - New homeowners spend 15% on new fixtures, furniture, etc.
 - Approximately 50% of the cost of every new home is the cost of building materials after the lot cost.
- There is some good news- new homes are selling but with builder discounts.
 - Before new homes can be constructed, the existing inventory must be sold.
 - Keys for recovery:
 - continued job growth in Virginia
 - a continuation of salary and wage increases
 - a low interest rate environment
 - a favorable regulatory environment in Virginia.
- Hoping for recovery by spring of 2009.

There was no public comment and the meeting adjourned at 10:05 A.M.